Ukraine-Russia Geopolitical Risk Analysis

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Determining outcomes with a conflict of this nature is difficult, given the complexity of the situation and limited historical precedence. In our current assessment, there is an extraordinarily wide range of outcomes and probabilities, from a best case of de-escalation and a revamped NATO-Russia relationship, to a worst case that would include both a Russian takeover of the entire Ukraine, followed by onerous Western sanctions directly targeting the Russian financial system. In between, outcomes include but are not limited to Russia taking over parts of Eastern Ukraine and establishing a land bridge to Crimea, proxy wars, missile and air attacks in new regions, aggressive cyber-attacks, an extended standoff and disruptions/accidents of gas pipelines and supplies.

For the moment we are staying the course in our investment strategy. The framework we present below is not intended to be a complete assessment of all possible actions and reactions. However, as risk managers and stewards of capital, our job is to identify the key issues and to have a game plan in place for potential impacts to economic growth, inflation, capital markets and our asset allocation positioning. Barring the worst-case outcome, we see limited negative impact on our positive view for a multi-year expansion in the US and our overweight to risk assets. Volatility in the short term, though, will likely rise until the crisis is over and equities could come under varying degrees of pressure. History shows the impact on equities from geopolitical tensions tend to be short-lived modest on average. Should the worst case unfold, we believe the European economy would be impacted much more than the US, reinforcing our underweight to European equities. Rest assured, we have a game plan to preserve capital should unanalyzable shocks occur that would raise the risks of recessions in the US meaningfully.

Source: CNR Research.

UKRAINE RISK MATRIX

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<th>SCENARIOS</th>
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<td>Extended standoff</td>
<td>Aggressive cyber-attacks</td>
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<td></td>
<td>Destabilize Ukraine</td>
<td>Air and missile campaign</td>
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<td>REACTION</td>
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<td>Increased arms shipments</td>
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<tr>
<td>Nord Stream 2 continues</td>
<td>Lower level sanctions</td>
<td>Sanction key firms &amp; Putin inner circle</td>
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</tr>
<tr>
<td></td>
<td>Proxy wars</td>
<td>Nord Stream 2 stopped</td>
<td>Sanction key firms and Putin inner circle</td>
</tr>
<tr>
<td>Probability</td>
<td>10-20%</td>
<td>30%</td>
<td>10-20%</td>
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<tr>
<td>US recession risk</td>
<td>No change</td>
<td>No change</td>
<td>Increases</td>
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<td>Inflation impact</td>
<td>No change</td>
<td>No change</td>
<td>Solidly higher</td>
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<td>Oil prices</td>
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<td>No change</td>
<td>Solidly higher</td>
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<td>Maintain/Uptick depending on market levels</td>
<td>Maintain/Uptick depending on market levels</td>
<td>Maintain/Uptick depending on market levels</td>
</tr>
</tbody>
</table>

Source: CNR Research.
Scenario Analysis

MOST LIKELY OUTCOMES
> Outcomes are broad, ranging from an extended standoff and increased cyber-attacks to more direct military intervention such as an air/missile campaign, or Russian deployment into occupied Donbas and attempts to seize a land corridor to Crimea.
> Western response measures would likely also be broad depending on Russian actions, and range from lower-level sanctions to increased military aid for Ukraine, more targeted sanctions, and a halting of planned operations for the Nord Stream 2 pipeline.

Investment Implications
> Economic impact would be manageable, with most notable impact being a modest increase to inflation resulting from higher food, energy and commodity prices. EU economy most impacted. Reduced uncertainty may warrant an increase in risk asset class exposure, depending on market levels and events.
> Near-term financial volatility will increase. A modest equity market sell-off is likely, and yields would trend modestly lower from heightened uncertainty causing investors to seek out safer assets.
> May present an opportunity for opportunistic buying, depending on market levels and events.

BEST-CASE SCENARIO
> Russia significantly lowers tensions and pulls back large amounts of troops and equipment from the Ukrainian border. 
> Arms shipments by NATO allies into Ukraine are stopped, and the Nord Stream 2 approval process continues.
> Diplomatic initiatives are restarted, though they would likely take months to conclude.
> Key discussion items include Ukraine sovereignty and NATO admissibility, a revisit of prior Minsk agreements, and a fresh start for NATO-Russian relations. Favorable terms on Nord Stream 2 gas pipeline and other energy supplies to Europe.

Investment Implications
> Under this scenario, economic and market impacts should be relatively minor.
> Reduced uncertainty may warrant an increase in risk asset class exposure, depending on market levels and events.

WORST-CASE SCENARIO
> Russia invades and takes control of Ukraine, and potentially cuts off energy exports to Europe.
> Western response measures would include substantial and broad sanctions on Russia’s central bank, sovereign debt, dollar transactions and potentially cutting Russia off from the international SWIFT global electronic payment messaging system.
> Targeted sanctions would also likely be applied on key Russian finance, energy and technology firms, as well as assets linked to Putin himself and other oligarchs.
> Sanctions will require western support to be fully effective.
> Direct NATO or US/Western military response is also a potential, though less likely, option.

Investment Implications
> Economic activity in Europe would be negatively impacted, with likely spillover into global economic activity.
> Risks to growth coming from sharply higher energy prices, tighter global financial conditions and negative shock on sentiment.
> US recession risk rises modestly, but US is best insulated.
> Shock could result in abrupt policy pivot from recent tightening direction, despite higher inflation.
> Financial volatility is expected to be high. Equity market correction is likely and yields are likely to fall meaningfully on a flight to safety.
> May necessitate a shift in investment strategy to capital preservation, depending on market levels and events.

MARKETS TEND TO BE RESILIENT

Source: FactSet.
INDEX DEFINITION

S&P 500 Index: The S&P 500 Index, or Standard & Poor’s 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. It is not an exact list of the top 500 U.S. companies by market cap because there are other criteria that the index includes.

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